

PUBLIC EMPLOYEES RETIREMENT BOARD MEETING

February 28, 2005

8:30 A.M.

A regular meeting of the Public Employees Retirement Board convened at 8:30 a.m., Monday, February 28, 2005, in the TierOne Community Meeting Room at 1221 N Street, Lincoln, Nebraska.

The Board members were notified of this meeting by letter dated February 18, 2005. Public notice of this meeting was published in the Lincoln Journal Star and Omaha World Herald on February 20, 2005. Mr. Peters chaired the meeting and Ms. Linder recorded the minutes.

MEMBERS PRESENT:

CHARLES PETERS, CHAIR
JULIA MOELLER, VICE-CHAIR
DENIS BLANK
WILLIAM HASTINGS
ROGER REA
DALE KAHLA
MARK SHEPARD
GLENN ELWELL
CAROL KONTOR, EX-OFFICIO

NONMEMBERS PRESENT:

ANNA SULLIVAN
Director
LYN HEATON
DAS – Deputy State Budget Administrator
MIKE DULANEY
NCSA
BEN MATTERN
Ameritas
HERB SCHIMEK
Nebraska State Education Assoc.
JOE SCHAEFER
Legal Counsel
TERESA ZULAUF
Internal Auditor
RON NIEWOHNER
IT Team Manager
JAN FOX
Training Supervisor
MARY JOCHIM
Sterling Financial Advisors
DALE RATHE
Retired School Plan Member
JENNIFER PERSON
State Auditor's Office
CINDY JANSSEN
State Auditor's Office
JASON HAYES
Legislative Retirement Counsel
RANDY GERKE
Accounting and Finance Manager
JANE HANSEN
Retirement Plan Supervisor
SHEILA LINDER
Administrative Assistant

Agenda Item Nos. 1 and 2 - Meeting Called to Order: Chairperson Peters called the February 28, 2005, Board Meeting to order at 8:31 a.m. Present at roll call: C. Peters, J. Moeller, D. Blank, W. Hastings, R. Rea, D. Kahla, M. Shepard, G. Elwell, and C. Kontor. Absent: None.

Agenda Item No. 3 - Approval of Minutes: Mr. Rea moved that the minutes of the January 24, 2005, Board Meeting be approved. Motion was seconded by Ms. Moeller. Members voted as follows:

For: J. Moeller, D. Blank, W. Hastings, R. Rea, D. Kahla, M. Shepard, G. Elwell, and C. Peters. Against: None. Motion carried.

Agenda Item No. 4 - Approval of Budget Status Report & January Retirement Report: Ms. Moeller moved to approve the budget status report and the January Retirement Report. Motion was seconded by Mr. Kahla. Members voted as follows: For: D. Blank, W. Hastings, R. Rea, D. Kahla, M. Shepard, G. Elwell, C. Peters, and J. Moeller. Against: None. Motion carried.

Agenda Item No. 5 - Public Comments or Correspondence from Citizens: There were no public comments or correspondence from citizens with business not scheduled on the agenda.

Agenda Item No. 6 - Review of School, Judges, and Patrol Audit Report: Cindy Janssen and Jennifer Person, from the State Auditor's Office, were present to provide the School, Judges, and Patrol Audit Report. Ms. Person was the main person on site during the audit. Ms. Janssen read the findings listed in the report.

Mr. Peters asked why auditing of schools was on our audit report since it is not our responsibility. Ms. Janssen stated NPERS does not need to look at 100%, a sampling is appropriate. Ms. Moeller stated this finding has been listed for several years and asked if it needs to be listed each year since we are working on it. Ms. Janssen stated the finding needs to be in the audit until a sampling or monitoring procedure is implemented. Mr. Rea asked if schools are informed of problems that are found with their school. Ms. Janssen replied that they do not formally make recommendations to the school districts. They may tell the school district something was found, give them their opinion, and let them know they can follow up with NPERS to address the issue. They visited approximately 30 school districts this year. They audit all 93 county courts so they are in each county every year.

Agenda Item No. 7 - Member Group Comments: Mike Dulaney, Associate Executive Director for the Nebraska Council of School Administrators, and Herb Schimek, Director of Government Relations for the Nebraska State Education Association, were present to provide input from their organizations.

Mr. Dulaney stated the 401A, deferred compensation plans, was a priority for NCSA this year and was embodied in LB 329. Also, LB 411, dealing with the salary spiking issue, has been a priority of NCSA. Mr. Dulaney stated he feels very strongly about this issue. They do not condone salary spiking. A bill was introduced last year and an interim study was completed this past summer. A cap on salaries was included in the bill that was introduced this year. Also included was self-reporting by school districts.

Mr. Schimek stated that the two organizations work together closely throughout the year regarding legislative matters. He stated there have been basically two problems this year. The teachers, administrators, and school employees are willing to make the additional contribution needed for the coming two years in order to ensure the plan remains solid. They appreciate the opportunity to communicate with the actuary. A bill will be heard this week dealing with the composition of the PERB Board. The bill would increase the membership by one person, who would be a retired school employee. Mr. Schimek stated this is nothing against the Board, they enjoy the relationship with the PERB board and the employees, especially the meetings that are held monthly when Ms. Sullivan brings them up to date on what is taking place.

Mr. Blank asked who bore the cost of an actuarial deficit in the past. Mr. Schimek stated in the past the member bore the cost if there was a deficit. They started working with Senator Wickersham in doing the five-year smoothing, which has helped tremendously. There was an agreement if additional money was needed due to deficit, the employees and employers would make up the deficit.

Mr. Rea asked how willing the groups are to look at rules regarding salary matters established by NPERS. Mr. Dulaney stated they would probably prefer to have it placed in statute. He also stated they would be willing to talk

about ideas of the Board for the future if the Board would want to have rules.

Agenda Item No. 8 - Legislative Update: Mr. Schaefer reported LB 329, which deals with separation pay, is on final reading; LB 503 was advanced from select file last Friday. LB 503 includes provisions of the original bill, including the testing element; LB 368, which is the school contribution bill; LB 411, dealing with compensation; LB 412, the patrol contribution rate increase; and LB 494, which was the investment option change for state and county members. LB 369 is not included in LB 503. They expect LB 503 to go to final reading today.

Ms. Sullivan distributed a sheet that was provided by Mr. Hayes, based on information from the actuary, showing the school contribution rate adjustment as a result of the Class V service annuity funding needed. Ms. Sullivan stated that NPERS requested in the original budget \$15.4 million to pay for the actuarial required contribution. In lieu of that, the plan members agreed to a contribution rate increase so that the state would not have to come up with those dollars. However, we need to use a piece of that funding that is dedicated to the Omaha system. The final rate needed will be close to 7.98% due to delayed implementation from July 1 to September 1, 2005.

Ms. Sullivan also distributed a five-year projection from the actuary for expected additional contribution requirements through 2009, based on July 1, 2004, actuarial valuation results. These projections are based on market value of assets earning 8%, with current liabilities being used. The actuary has been saying by smoothing the losses since 2001, we are only recognizing 1/5th of the losses each year so it will take awhile before we get to the bottom.

This information will be provided to the Legislative Fiscal Office, the Retirement Committee, the Budget Office, and the Governor's office.

Mr. Blank asked who is liable for an actuarial deficit in the defined benefit plans. Ms. Sullivan stated public pension plans have always had a member contribution rate. It is a state sponsored plan. The statute says the State will make any actuarial required contributions. The State can say we are going to raise member rates to cover that. That has been the position of the Retirement Committee.

Mr. Blank stated as a fiduciary he does not feel comfortable in not coming out and taking a position that plan members not pay for the actuarial deficits. He stated the Board has a responsibility to do something. Ms. Sullivan stated Mr. Dulaney and Mr. Schimek's comments are the political reality. The State has other budget issues. Ms. Sullivan also stated the Board's first responsibility is to the members as fiduciaries. Mr. Schaefer stated the duty as fiduciary is first to the plan, that the plan be fully funded, then to the members. Mr. Rea agreed with Mr. Blank that the position taken by the Board last month should be the position of the Board on an on-going basis.

The motion made at the January meeting was made out of order on the agenda. Mr. Blank moved that the PERB adopt a general policy of opposing increases in defined benefit plan member contribution rates to correct actuarial deficiencies caused by market declines. Mr. Rea seconded motion. Question was raised if this matter can be handled at this time since the item is not listed specifically on the agenda and the Legislative Update is not listed as an action item.

Judge Hastings moved to table the matter until the March meeting with the direction to place on the agenda the philosophical approach to the funding. Ms. Moeller seconded the motion. Members voted as follows: For: W. Hastings, R. Rea, D. Kahla, M. Shepard, G. Elwell, C. Peters, J. Moeller, and D. Blank. Against: None. Motion carried.

Mr. Rea noted he does not interpret the open meetings law the same way Mr. Schaefer does. If something is placed on the agenda, action can be taken any time during the meeting.

Mr. Hayes stated the legislative update was listed as an action item in January. It would benefit the Board to list the item as an action item so those interested can attend the meeting and provide their input.

Mr. Hayes noted that no employee will have their pay reduced. Every employee who gets a contribution rate increase will have a corresponding pay increase which is greater.

Mr. Rea asked to have Section 79-966.01 of the statute referenced. "...the actuary shall determine the added contributions required to be paid by the State of Nebraska that constitute the difference between the actuarially

required contribution rate and the rate of all other required contributions.”

LB 369, dealing with the Judges’ contribution rate, was not included in LB 503. Negotiations are still going on with the Judges.

Mr. Shepard stated LB 503 incorporates most everything in LB 411. Items in the audit report may not necessarily be addressed by LB 503. It really does not address the issue of consistency state-wide. This is going to be an issue until the state deals with and truly defines contribution as everything is included or everything is out. Ms. Sullivan noted that every school district treats their benefits differently.

Mr. Schaefer reported he is expecting to hear about committee action on LB144, which deals with school statements and LB 366, which deals with the contribution rate for state members being a straight 4.8%. These will likely be attached to LB 364 that is still in committee.

The Board took a break at 10:22 a.m. and reconvened at 10:33 a.m.

Agenda Item No. 9 - Internal Auditor’s Annual Report: Teresa Zulauf, NPERS Internal Auditor, provided her Annual Report. Her goals are to clean up all prior audit points, address issues the auditors bring forward, and to stop issues so they do not come forward. She is working on a three-year audit plan and a work schedule. She will be working with state agencies and county clerks to get set procedures and more documentation for the auditors. She is also trying to anticipate LB 503 because it will greatly affect the office.

Mr. Rea asked if Ms. Zulauf follows up with people when errors are found by the auditors. Ms. Zulauf has been following up with school payroll personnel and county clerks. Mr. Blank asked Ms. Zulauf if she has counterparts in other state agencies that she can contact to see how other agencies handle travel and food expenses, for example. She will contact other agencies to see how they are handling. The auditors may not be applying rules consistently across the agencies.

Ms. Sullivan noted when the Internal Auditor position was first created, it was not to audit employers. Now with the implementation of LB 503, a sampling will be done of the school, judges, patrol, and counties. An additional employee has been requested in the fiscal impact statement for LB 503.

Agenda Item No. 10 - Technology Plan Update: Mr. Niewohner reported he has completed a systems evaluation that went well. All servers are running Windows 2000. We can start upgrading to Windows 2003. They are setting up a test environment for that. All the server hardware and storage requirements are adequate. All the utility servers are on the latest firmware. Overall the network is in great shape. With regard to security, we have three portholes in and out of our network, one to Ameritas; one through the Department of Communications, and one with Covansys that allows them to connect directly to our user connection testing environment. We have no wireless access points to our network.

The team consists of two business analysts, a programmer who handles systems support programming issues and desktop support, a desktop support person, and a network administrator. There is a need for an additional object orientated programmer.

Security-wise, the system is very tight. Ms. Sullivan noted that one audit point dealt with staff not being required to change passwords to access PIONEER. Staff are required to change the overall password to get on our network and no one can get to PIONEER without logging into the network.

Mr. Blank left the meeting at 11:06 a.m.

Agenda Item No. 11 - Investment Council Update: Ms. Kontor reported they have received the final numbers for the fourth quarter of 2004. For the twelve-month period ending December 31, the rate of return was 11.4% in the DB plans. The three years ending December 31 the rate of return was 7.7%. The five-year rate was not as good. For the Cash Balance plan the rate of return was 11.1%

The Investment Council has been considering and talking about private equities for approximately 18 months. They decided at the last meeting to allocate 5% of the assets to private equities and they are starting with an initial funding

of \$150 million dollars in the DB plan with a corresponding allocation in the Cash Balance plan.

They have asked Ennis Knupp, the investment consultant, to do an asset liability study. They expect to have the report presented at the Investment Council's May meeting. Ms. Sullivan stated NPERS' actuary did express some concern about not being involved in the study. Ms. Sullivan asked that he be present when the report is presented or that Ennis Knupp contact Mr. Slishinsky. Ms. Kontor stated the report is based on the last actuarial report. Information will be shared between Mellon and Ennis Knupp. The Investment Council will look at various asset allocations.

In looking at the international equity, the Council moved \$100 million from actively managed investment to passive. They are looking at the mandate to broaden the criteria on international equity managers and examining if this impairs managers. They are looking at different manager mandates and asset allocations.

The Investment Council approved a risk budgeting policy and a cash management policy.

The letter that Ms. Kontor and Ms. Sullivan sent to the Hartford participants was included in the Board packets. The letter notified Hartford account members about the two funds that were discontinued and that any assets members held in those two funds would be moved.

Hartford will be asked to report at either the March or April Board Meeting.

Judge Hastings moved to approve the Investment Council report. Mr. Kahla seconded the motion. Members voted as follows: For: R. Rea, D. Kahla, M. Shepard, G. Elwell, C. Peters, J. Moeller, and W. Hastings. Against: None. Motion carried.

Agenda Item No. 12 - Director's Report: Ms. Sullivan distributed a copy of her Director's Report and mentioned a copy of the IRS qualification letter was included in the Board packet. All five plans are now requalified. A determination does not expire.

Ms. Sullivan reviewed her report. The biennial budget request was submitted last fall. The numbers were revised as a result of the actuarial reports that came out in November. The programmer that was requested has not been included in the preliminary budget, nor funding to send the IT team to California for training and to Columbus, Ohio, for training to maintain the system. Ms. Sullivan and Mr. Gerke will meet March 2 with the fiscal analyst to go over justification for these items.

Ms. Sullivan distributed an email from David Powell regarding employer contribution forfeitures. She noted that forfeitures are plan assets. Cash balance forfeitures can only be used for cash balance expenses and those employees that are reinstated. A follow-up meeting will need to be held to reach consensus on forfeiture dollars so there are not any ongoing concerns.

Ameritas is the official record keeper and they do the accounting. The funds stay at our custodial bank, State Street. We have never booked the assets on the state accounting system because this is being done at Ameritas. The auditors suggested that the Cash Balance assets be booked on the state accounting system and we have done this. By doing so we are able to show the reconciliation of the two amounts between State Street and Ameritas.

Ms. Moeller and Ms. Sullivan attended the legislative conference in Washington, D.C., earlier this month. Ms. Sullivan stated she has been concerned about Section 414(h) of the IRS Code. There is talk of rescinding it. She and Ms. Moeller visited staff of our two senators and three house members.

Judge Hastings moved to approve the Director's report. Mr. Rea seconded the motion. Members voted as follows: For: D. Kahla, M. Shepard, G. Elwell, C. Peters, J. Moeller, W. Hastings, and R. Rea. Against: None. Motion carried.

Agenda Item No. 13 - Review of Draft Annual Report to the Legislature: Ms. Sullivan distributed a draft of the Annual Report that is not complete at this time. Mr. Peters stated on the organizational chart it should show that while the Legal Counsel, the Internal Auditor and the Actuary report to the Board they also report to the Director. Mr. Schaefer stated by statute the Director, legal counsel, and the internal auditor are hired by the Board. LB 503

states that the PERB hires them. Ms. Sullivan asked the Board to review the report. The final report will be emailed to the board members prior to the presentation to the Retirement Committee on the 23rd of March.

Agenda Item Nos. 14 and 15 - Executive Session: At 12:13 p.m., Ms. Moeller moved that the Board exit Regular Session and convene in Executive Session for the purpose of discussing disability applications from plan members and other legal matters. Motion was seconded by Mr. Rea. Members voted as follows: For: M. Shepard, G. Elwell, C. Peters, J. Moeller, W. Hastings, R. Rea, and D. Kahla. Against: None. Motion carried.

Judge Hastings left the meeting at 1:10 p.m.

At 1:14 p.m., Ms. Moeller moved that the Board exit Executive Session and reconvene in Regular Session. Motion was seconded by Mr. Kahla. Members voted as follows: For: G. Elwell, C. Peters, J. Moeller, R. Rea, D. Kahla, and M. Shepard. Against: None. Motion carried.

Ms. Moeller moved for approval of the disability applications of K. Gustin and L. Naber. Mr. Elwell seconded the motion. Members voted as follows: For: C. Peters, J. Moeller, R. Rea, D. Kahla, M. Shepard, and G. Elwell. Against: None. Motion carried.

Mr. Rea moved to adopt the Findings of Fact and Conclusions of Law in the Garwood case and direct the Chair to sign the Order. Mr. Kahla seconded the motion. Members voted as follows: For: J. Moeller, R. Rea, D. Kahla, M. Shepard, G. Elwell, and C. Peters. Against: None. Motion carried.

Agenda Item No. 16 - New Board Committee Assignments: The 2005 Board Committee Assignments and Duties list was distributed. Each committee will select the Chair of the committee. The Budget Committee will have a meeting by phone this month.

Agenda Item No. 17 - Finalize 2005 Meeting Schedule: The list of tentative agenda items for the remainder of the year was provided to the Board. Discussion was held regarding a location for the retreat and the auditors' concern. The Board directed Ms. Sullivan to see if the Lied Lodge Conference Center in Nebraska City is available.

The IT Team Update will be provided every other meeting. Mr. Blank stated he has a conflict on March 21. However, due to other conflicts, the Meeting must be held on March 21 as scheduled.

The June meeting date conflicts with the NCTR summer meeting. The June Board Meeting will be held on Thursday, June 23, 2005.

Agenda Item No. 18 - Chairperson's Comments: Mr. Peters stated the Board cannot supervise the internal auditor and legal counsel. The Board hires the administrator. The Board's role is to make policy, not to administer. The auditors say the Board does not have enough oversight. The Board members listen to what the Director has to say and the reports presented by the supervisors. Mr. Peters state that the Board needs to congeal the concept that it does policy.

Agenda Item No. 19 - Future Meetings/Agendas: Ameritas will host the March 21st meeting at its office at 59th and O Streets.

Agenda Item No. 20 - Adjournment: Ms. Moeller moved that the meeting adjourn. Motion was seconded by Mr. Rea. Members voted as follows: For: R. Rea, D. Kahla, M. Shepard, G. Elwell, C. Peters, and J. Moeller. Against: None. Motion carried.

The meeting adjourned at 1:46 p.m.

Anna J. Sullivan
Director